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C O N F I D E N T I A L SECTION 01 OF 02 BEIJING 000147

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TREASURY FOR LOEVINGER

E.O. 12958: DECL: 01/20/2030
TAGS: ECON EFIN ETRD CH
SUBJECT: CHINA/RMB: CHINESE INDICATE X-RATE UNLIKELY TO MOVE SOON

Classified By: Economic Minister Couselor William Weinstein, Reasons 1. 4, b,d

¶1. (C) Summary. In recent public and private statements, senior officials indicated China does not intend to adjust its exchange rate--essentially pegged to the U.S. dollar since August 2008--anytime soon. Further, officials pushed back hard against the idea that foreign pressure could sway the discussion, reiterating time and again that China would proceed only on its own terms and schedule. The majority of Chinese and Beijing-based foreign analysts believed that the Chinese government would not restart gradual RMB appreciation until the country posted at least 3-6 months of strong export growth. While most of the Chinese leadership appeared to have rejected foreign exchange movements for the time being, there were still voices supporting appreciation, however, making it impossible to completely rule out a surprise currency move. End Summary.

A Stable Currency

¶2. (SBU) During a December 27, 2009 Xinhua interview, Premier Wen Jiabao observed that "a stable Chinese currency benefits the international community" and "countries that demanded RMB appreciation while practicing trade protectionism against China are holding back China's development." Wen, while not explicitly ruling out exchange rate adjustments, emphasized that any changes will be driven by domestic considerations, not international pressure.

¶3. (SBU) On January 7, 2010, Minister of Commerce (MOFCOM) Chen Deming told the press that China's maintenance of a basically stable RMB foreign exchange rate was conducive to global economic recovery. He said "China's trade volume is 10 percent of global trade volume. An unstable RMB foreign exchange rate would have a big impact on global trade." Chen allowed that eventually the exchange rate would be reformed to become "controllable but more free-floating."

¶4. (SBU) Several days later, the Bank of China Institute released a report claiming the current exchange rate is at a basically rational level. That report also noted China's intention to establish a policy that will maintain a "basically stable" rate while also accommodating some of the growing pressure to appreciate.

¶5. (C) Senior officials from the People's Bank of China have passed the same message to U.S. Government officials in private-there isn't any internal support for changing the exchange rate. Opposition from local government and the export sectors are too strong.

Pressure to be Resisted

¶6. (C) Premier Wen, in the Xinhua interview, stated "we will never yield to pressure for RMB appreciation." On January 8, Assistant Minister of Finance Zhu Guangyao restated to Treasury officials that China will only appreciate the RMB on its own terms and schedule, not in response to foreign pressure.

¶7. (SBU) This theme -- that China will resist foreign pressure to adjust its exchange rate regime -- was echoed in both the Chinese media and on web commentary over the past few weeks. Much of the discussion took on a quasi-nationalist cast, with calls to defend China's interests in the face of foreign pressure.

¶8. (SBU) Chinese and Beijing-based foreign analysts generally accept the Government statements at face value. Goldman Sachs' Helen Qiao, for example, opined that "the Chinese government will not yield to foreign pressures for the RMB to appreciate, even if China's trading partners are threatening to impose punishment on its exports." She observed that the recent Beijing rhetoric was particularly harsh, raising doubts that there would be any moves in the near term on currency.

When Will It Move?

¶9. (SBU) CLSA's Andy Rothman and UBS's Wang Tao both felt that, after 3-6 months of proven solid exports and economic recovery in the United States and Europe, the Chinese government might restart gradual RMB appreciation. From

Rothman's point of view, such recovery was important to sell appreciation to the domestic audience.

¶10. (SBU) Goldman's Qiao noted, however, that there were significant reasons to appreciate. She explained that strong economic growth and property price inflation remained a concern, creating a more conducive environment for appreciation. Perhaps in a somewhat counter-intuitive way, Qiao thought the vehement denials of appreciation could actually help create a political window to move, albeit not straight away, since such statements gave policymakers more credibility to move down the road. Unfortunately, the window for politically-palatable appreciation was closing. Qiao explained that foreign pressure for appreciation would become more pronounced as the June G20 summit approaches, creating a difficult situation for Beijing policymakers anxious to be seen as resisting outside influence.

Some Appreciation Supporters

¶11. (SBU) Give the general consistency of Chinese messages, National Development and Reform Commission (NDRC) Vice Chairman Zhang Xiaoqiang attracted considerable attention when he said to the press on January 5, 2010 that "due to the loose monetary policy of developed countries and the weak U.S. dollar, the RMB has been facing appreciation pressure recently, which may attract large sums of hot money."

¶12. (SBU) Zhang Bin, of the World Political and Economic Research Institute of the China Academy of Social Sciences, also attracted attention when he told the press on January 12 that the RMB should have a one-off appreciation of 10 percent. According to Zhang, although such an appreciation might slow China's export growth by 3.3 percent, it also could allow China to avoid speculative inflows and thereby reduce the short-term blow to the economy, as well as help restructure the economy away from exports. Zhang warned that if the USD continues to depreciate in 2010, and the RMB with it, appreciation pressure from the European Union might exceed that from the United States. He explained, however, that most observers believed rate appreciation had lost favor

with Wen Jiabao because he perceived that the 2005-08 appreciation had led to dangerous speculative inflows.
HUNTSMAN